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April 4, 2001

Ex Parte

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th St., S.W. – Portals
Washington, DC 20554

RE: Application by Verizon New England Inc., et al., for Authorization To Provide In-Region, InterLATA Services in Massachusetts, Docket No. 01-9

Dear Ms. Salas:

The enclosed letter was provided as follow up to meetings with the Commissioner offices' staff. Please let me know if you have any questions. The twenty-page limit does not apply as set forth in DA 01-106.

Sincerely,

Dee May

Enclosure

cc: B. Tramont
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April 4, 2001

Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Dear Chairman Powell:

Verizon's rates for unbundled network elements in Massachusetts comply fully with the Act, and our application to provide long distance service should be approved.

Local competition in Massachusetts is thriving, with competitors serving more than 850,000 lines, including more than 550,000 lines over their own facilities. Indeed, the undisputed record in this proceeding shows that, in proportion to the number of statewide access lines, competitors are serving significantly more lines in Massachusetts — and significantly more facilities-based lines — than in any of the four states that have received section 271 authority at the time applications were filed in those states.

Likewise, competing carriers are using DSL-capable loops in Massachusetts to an even greater extent than in any of the other states where the Commission has granted section 271 authority. And while the principal issues raised in connection with Verizon's original application concerned Verizon's performance in providing access to DSL-capable loops, those issues have now been comprehensively addressed.

The remaining issue in dispute concerns Verizon's rates for unbundled switching. As all concerned parties have acknowledged, Verizon previously reduced its unbundled switching rates to the same levels as in New York.[1] These are the same rates that have permitted competitors to obtain more than 1.5 million local lines using unbundled elements in New York. They are the same rates that have caused two of the nation's largest consumer organizations — Consumer Federation of America and Consumers Union — to call New York "the most stunning example"

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1 See, e.g., Massachusetts DTE Evaluation, CC Docket No. 00-176, at 222 (finding Verizon's switching rates "virtually identical to those same costs for New York").

"of how effective competition can deliver benefits to consumers in communications markets."[2] They are the same rates that WorldCom has said "allow[] entry" and that should be held up as "the standard that other Bell companies must meet in opening their local markets."[3] And, while the Commission correctly has found that the size of the discount from retail is not relevant in evaluating UNE prices, they are the same rates that produce an effective discount of 48 percent for the average residential customer in Massachusetts.[4]

Moreover, the New York PSC, this Commission, and the D.C. Circuit all have concluded that Verizon's switching rates comply fully with TELRIC principles. For example, the PSC stated that it "applied a forward-looking TELRIC method consistent with that prescribed in the FCC's pricing rules," and that Verizon's rates were "well within the range of reason as established by the TELRIC-based record."[5] The Commission found "no basis to disagree with the New York Commission's assertion," that the PSC had followed TELRIC principles, and that the resulting rates were within the range that a reasonable application of TELRIC would produce.[6] And the D.C. Circuit held that the Commission's decision "seems reasonable to us."[7]

Despite all this, AT&T and WorldCom claim that the switching rates adopted by the New York PSC were set at the wrong level. They claim that Verizon mistakenly said that certain switch discounts applied only to the new digital switches that Verizon deployed to replace old analog switches, and not to other switches.

But AT&T and WorldCom have been making this exact same argument for nearly three years, and it has been squarely rejected by the New York PSC, this Commission, and the D.C. Circuit. All three have concluded that AT&T and WorldCom's argument regarding Verizon's switching discount is flawed in three critical respects, and that Verizon's switching rates comply with TELRIC.

First, they all have noted that Verizon's switching rates were not based on Verizon's own studies, but rather "grounded on an analysis undertaken by the NYPSC's Staff."[8] Moreover, in

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2 Consumer Federation of America and Consumers Union, Lessons from 1996 Telecommunications Act: Deregulation Before Meaningful Competition Spells Consumer Disaster at 9 (Feb. 2001).

3 Verizon Application, Appendix B, Tab 565 (Transcript at 5599) (Testimony of Robert Lopardo, Regional Director, Public Policy, WorldCom); WorldCom Press Release, MCI WorldCom Responds to FCC Decision on Bell Atlantic Long Distance Application (Dec. 22, 1999).

4 See Ex Parte Letter from D. May to M. Salas, CC Docket No. 00-176, at 6 (Nov. 21, 2000).

5 New York PSC Evaluation at 156; New York PSC Reply at 48.

6 New York Order ¶ 246.

7 AT&T v. FCC, 220 F.3d 607, 617 (D.C. Cir. 2000).

8 New York PSC Reply at 48; see also New York Order ¶ 242; AT&T v. FCC, 220 F.3d at 617.

conducting this analysis the PSC "specifically considered AT&T's assertions about switching discounts," and "[a]s a result, Bell Atlantic's switching prices were greatly reduced, with a final result that is very close to AT&T's estimated switching prices."[9]

Second, they all have agreed that the PSC could not simply make a "selective update" or "simple arithmetic correction" to Verizon's switching rates because any change in the assumption regarding discounts would affect other assumptions "with unpredictable results."[10] Indeed, the PSC noted that "[o]nce switching costs were reopened, one might also envision changes to the Staff analysis that would *increase* the calculated switching costs."[11] The Commission found that "AT&T has presented no evidence to persuade us that New York did not conform to TELRIC principles simply because it failed to modify one input into its cost model."[12] And the D.C. Circuit held that, "[u]nder these circumstances, we are comfortable deferring to the Commission's conclusion that basic TELRIC principles have not been violated."[13]

Finally, they all have concluded that, even if new evidence might result in a refinement of Verizon's rates, the existing rates are "no less TELRIC compliant" as a result.[14] The New York PSC noted, for example, that "the new information might warrant modifying that estimate in one way, but the prospect of that modification would not negate the overall reasonableness of the rates we set."[15] The Commission held that AT&T "has presented no evidence" to "refute the New York Commission's claim that these rates may be refined in the future, 'but they are no less TELRIC-compliant on that account.'"[16] And the D.C. Circuit held that the Commission's "conclu[sion] that the prospect of future modification makes the rates no less TELRIC-compliant . . . seems reasonable to us."[17]

In addition to claiming that the rates in New York were set at the wrong level, AT&T and WorldCom argue that the Commission should reject the Massachusetts rates because they are permanent whereas the rates in New York are interim and subject to true up.[18] Of course, this is a 180 degree reversal from the New York proceeding where AT&T and WorldCom argued that the rates were invalid precisely because they were interim. In any event, as the New York PSC,

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9 New York Order ¶ 246.

10 Order Denying Motion to Reopen Phase 1 and Instituting New Proceeding, Cases 95-C-0657 et al., at 8, 10 (NYPSC Sept. 30, 1998).

11 Id. at 10-11.

12 New York Order ¶ 245.

13 AT&T v. FCC, 220 F.3d at 617-618.

14 New York PSC Reply at 48.

15 Order Denying Motion to Reopen Phase 1 and Instituting New Proceeding at 10.

16 New York Order ¶ 247 (quoting New York PSC Reply at 47).

17 AT&T v. FCC, 220 F.3d at 617.

18 See New York Order ¶ 247 (rejecting AT&T's argument that the New York rates should be rejected because they were interim).

the Commission, and the D.C. Circuit all have held, whether the rates at issue are interim or permanent is not relevant to the ultimate question of whether those rates comply with TELRIC principles. The PSC noted, for example, that "the switching rates now in effect should not be seen as mere 'placeholders.' They embody a reasonable calculation of pertinent costs, arrived at by the NYPSC Staff's application of forward-looking TELRIC analysis."[19] The Commission found that "AT&T has presented no evidence that the New York Commission's 'ongoing examination of the [switch discount] issue betokens a failure to set TELRIC-compliant rates.'"[20] And the D.C. Circuit agreed with the "Commission's conclusion that basic TELRIC principles have not been violated." [21]

AT&T and WorldCom's objective here is plain. Whereas this Commission has made clear that there are a range of rates that can result from a reasonable application of its TELRIC rules, AT&T and WorldCom want to force all states to the lowest common denominator. In fact, WorldCom unabashedly states that, even if the Massachusetts rates "could be defended on cost," the Commission should impose lower rates unless the state commission can "provide a detailed, persuasive explanation of why no lower rate would satisfy TELRIC principles."[22] But that simply is not the standard.

Recognizing this fact, AT&T and WorldCom are left to argue that Verizon should be required to alter its switching rates in Massachusetts based on the outcome of the rate proceeding that is now underway in New York. But Verizon's Massachusetts rates already are at a level that the Commission has found fall within a range that a reasonable application would produce, and there is no legal basis on which to require more. Moreover, the Massachusetts DTE also has commenced a proceeding comprehensively to review Verizon's UNE rates, and this proceeding is scheduled to be completed later this year, at most within a few months after a final decision in the New York rate proceeding. In addition, requiring Verizon to adopt in Massachusetts the rates set in Albany, rather than Boston, would usurp the DTE's role in establishing rates, despite the Act's clear language assigning each state the role of assigning the rates, and despite the DTE's particularly earnest attention to this role in the past.

Ultimately, AT&T and WorldCom's argument boils down to a bald claim that the Massachusetts DTE is not competent to set rates, and not committed to fostering local competition. Indeed, this is precisely the claim that WorldCom blatantly asserted in a recent debate in one of the Commissioner's offices.

But the fact of the matter is that the DTE has demonstrated that these claims are grossly misplaced, and the record in this proceeding proves this beyond serious dispute. The DTE conducted an exhaustive 16-month review of Verizon's checklist compliance. It conducted extensive proceedings to set Verizon's rates, which produced some of the largest wholesale

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19 New York PSC Reply at 48.

20 New York Order ¶ 247 (quoting New York PSC Reply at 47).

21 AT&T v. FCC, 220 F.3d at 617-618.

22 WorldCom Supplemental Comments, CC Docket No. 01-9, at 8.

discounts and one of the lowest urban loop rates in the country. And it has adopted policies that aggressively promote all forms of competition.

All of this is borne out by the fact that Massachusetts has proportionately more local competition than in any of the four states that have received section 271 authority at the time applications were filed in those states. And it is further confirmed by the fact that, on a proportionate basis, there is more facilities-based competition in Massachusetts *today* — including more facilities-based competition to residential customers — than in any of the states of that have received section 271 authority.

Sincerely,

Attachment

cc: Commissioner Furtchgott-Roth
Commissioner Ness
Commissioner Tristani
K. Dixon
J. Goldstein
B. Tramont
S. Whitesell
D. Attwood
M. Carey
E. Einhorn
K. Farroba
S. Pie

VERIZON'S DISCOUNTS ON NEW SWITCHES

AT&T and WorldCom argue that Verizon's switching rates in Massachusetts, which are at the same levels as the switching rates in New York, are based on misstatements by Verizon regarding its discounts on new switches and, therefore, do not fall within the range that a reasonable application of TELRIC principles would produce. AT&T and WorldCom have been making this exact same argument for nearly three years, and it has been squarely rejected by the New York PSC, this Commission, and the D.C. Circuit.

1. In April 1997, the New York PSC established Verizon's rates for unbundled switching. There were three cost studies before the PSC – one from Verizon, one from AT&T and MCI, and one from the PSC staff. The PSC based Verizon's switching rates on the study submitted by the PSC's staff, which resulted in a rate that was much closer to the AT&T/MCI study than to the Verizon study.

2. In June 1998, AT&T and WorldCom moved to reopen the New York PSC's proceeding that established unbundled switching rates. They claimed that "new evidence" – in particular contracts between Verizon and its two largest switch vendors – revealed that one of the two vendors gave Verizon large discounts on both new and replacement switches, not just on replacement switches as Verizon had previously indicated, and as the New York PSC assumed in establishing Verizon's switching rates.

3. In September 1998, the New York PSC rejected AT&T and WorldCom's motion.

   - *First*, the PSC noted that it based Verizon's switching rates on the analysis of its own staff, not on the study submitted by Verizon.

     "Struck by the extremely wide discrepancy between the switching cost figures used by the two studies (New York Telephone's $586 per line and Hatfield's $125 per line, both inclusive of installation costs), we regarding that gap as itself calling the figures into question and went on to cite various other factors that led us to reject both estimates. We used, instead, a Staff analysis that was based on a per-line installed cost, derived from historical data, of about $300. . . . In the Phase I Rehearing Opinion we affirmed our switching cost analysis in the face of challenges by both New York Telephone and MCI. . . . We rejected . . . New York Telephone's critique, including a claim, which we found unproven, that the 5.72% price reduction factor [which reduced the price per line to $193] was belied by certain Bureau of Labor Statistics data . . ." (at 3-4)

   - *Second*, the PSC found that it could not simply make a "selective update" or "simple arithmetic correction" to Verizon's switching rates because any change in the assumption regarding discounts would affect other assumptions "with unpredictable results." (at 8, 10)

"[W]hile the adjustment called for here would not be an update, the rationale for disfavoring selective updates – they fail to recognize that other updates might move in the opposite direction – bears on selective after-the-fact modifications such as this one, as well. . . . Once switching costs were reopened, one might also envision changes to the Staff analysis that would *increase* the calculated switching costs . . . . The web of interconnected effects argues strongly against making the selective modification urged by the motion without a comprehensive review of switching costs or, indeed, all element costs." (at 10-11)

- *Third*, the PSC found that, even if the new evidence regarding Verizon's switch discounts might result in a downward adjustment in Verizon's rates, the rates were no less compliant with TELRIC as a result.

  "Staff regarding its Phase 1 switching cost result, and we adopted it, not as a mathematically precise calculation of switching costs but as a reasonable forward-looking estimate, building on actual historical data that included both new switches and 'growth' additions to existing switches, that could be used to set rates given the wide gulf between the parties' estimates and in the absence of a persuasive study by any party. *The new information might warrant modifying that estimate in one way, but the prospect of that modification would not negate the overall reasonableness of the rates we set.*" (at 10)

4. In the proceedings before this Commission regarding Verizon's New York § 271 Application (which took place between September and December 1999), AT&T and WorldCom again claimed that Verizon's switching rates were not TELRIC compliant because they relied on incorrect assumptions regarding Verizon's discounts on new switches. In its Evaluation and Reply Comments, the New York PSC again rejected these arguments.

   - *First*, the PSC again stated that it based Verizon's switching rates on the analysis of its own staff, not on the study submitted by Verizon, and that the resulting rates complied with TELRIC.

     "More fundamentally, AT&T implicitly mischaracterizes the New York Commission's treatment of switching costs in Phase 1. The decision was grounded on an analysis undertaken by the NYPSC's Staff after recognizing the serious flaws in both Bell Atlantic-NY's study and the Hatfield Model proffered by AT&T and MCI WorldCom. The result of that analysis was adopted "not as a mathematically precise calculation of switching costs" but as a figure, well within the range of reason as established by the TELRIC-based record, that was more reliable than the widely differing results of the parties' flawed, competing studies." (PSC Reply at 48)

     "Rates for resale, network elements and interconnection (reciprocal compensation) have been set that satisfy the 1996 Act and the FCC's avoided cost and TELRIC rules thereunder." (PSC Eval. at 152) "In setting prices, the

NYPSC has applied a forward-looking TELRIC method consistent with that prescribed in the FCC's pricing rules." (PSC Eval. at 156) "[W]e can advise the FCC that prices conforming to the FCC's requirements are in effect for resale, interconnection, and unbundled network elements provided by Bell Atlantic-NY." (PSC Eval. at 162).

- *Second*, the PSC again stated that it could not simply modify a single input in isolation, and that doing so likely would require offsetting changes in other inputs.

  "AT&T's criticisms appear misdirected in two respects. First, as the NYPSC itself observed, the decision reflects a complex analysis that does not lend itself to simple arithmetic correction through adjustment of a single input." (PSC Reply at 48)

- *Third*, the PSC again stated, even if the new evidence regarding Verizon's switch discounts might result in a downward adjustment in Verizon's rates, the rates were no less compliant with TELRIC as a result.

  "Thus, AT&T's criticisms appear misdirected in two respects. . . . Second, *the switching rates now in effect should not be seen as mere "placeholders." They embody a reasonable calculation of pertinent costs, arrived at by the NYPSC Staff's application of forward-looking TELRIC analysis.* The evidence cited by AT&T may imply need to refine those rates in one direction; but, contrary to AT&T's suggestion, not only the magnitude but even the direction of the overall body of refinements that may prove warranted cannot now be foreseen. *The rates remain temporary pending those refinements, but they are no less TELRIC-compliant on that account.*" (PSC Reply at 48)

5. In December 1999, the FCC explicitly rejected AT&T's and WorldCom's claims, affirmed each of the three grounds on which the New York PSC reached the same conclusion, and granted Verizon's application.

   - *First*, the Commission affirmed that the PSC had relied on its own cost study, rather than the studies proposed by Verizon or AT&T/MCI and that the resulting rates comply with TELRIC.

     "We reject AT&T's allegation that Bell Atlantic's switching prices violate TELRIC principles because they fail to account for any cost savings from the steep switch discounts that an efficient carrier operating in the long run would unquestionably receive. AT&T previously raised this issue with the New York Commission, which considered AT&T's assertion and made significant modifications to Bell Atlantic's proposed switch prices. Using its TELRIC-based model, Bell Atlantic calculated an average total installed switch investment of $586 per line. This switch cost was significantly higher than those calculated by AT&T under the Hatfield model, which calculated a per-line switch investment of $125. The New York Commission held that the wide disparity between the two

TELRIC models' inputs called both figures into question, and that the record before it suggested that neither figure was reliable. The New York Commission then conducted its own examination into switching costs, after which it estimated a per-line switch cost of $303, which it reduced to $192 to account for declining switch prices within the industry. The New York Commission contends that the resultant switch prices are TELRIC-based. Based on the evidence in the record, we find that the New York Commission has already considered AT&T's allegation that Bell Atlantic's proposed switch costs were too high and responded appropriately. Bell Atlantic may only recover $192 per switch per line, a significant reduction from its original proposal of $586 per line and an amount much closer to AT&T's estimation. We have no basis to disagree with the New York Commission that its calculation of switching costs is a 'reasonable calculation of pertinent costs, arrived at by the New York Commission Staff's application of forward-looking TELRIC analysis.'" (¶ 242)

"We find no basis to disagree with the New York Commission's assertion that it calculated pertinent costs 'arrived at by the NYPSC Staff's application of forward-looking TELRIC analysis.' Moreover, we are not persuaded that Bell Atlantic's switching costs are based on speculation, simply because AT&T believes the New York Commission did not adequately reflect switching discounts. As discussed above, the New York Commission engaged in extensive fact-finding in its rate case, and specifically considered AT&T's assertions about switching discounts. As a result, Bell Atlantic's switching prices were greatly reduced, with a final result that is very close to AT&T's estimated switching prices, further undermining AT&T's claims that Bell Atlantic's switch prices are double or even triple what they should be." (¶ 246)

- *Second*, the Commission affirmed the PSC's finding that it could not simply modify a single input in isolation, and that doing so likely would require offsetting changes in other inputs.

  "We also agree with the New York Commission that its determination of allowable switch costs was the result of a complex analysis that does not lend itself to simple arithmetic correction through the adjustment of a single input. AT&T has presented no evidence to persuade us that New York did not conform to TELRIC principles simply because it failed to modify one input into its cost model." (¶ 245)

- *Third*, the FCC affirmed the PSC's conclusion that, even if the new evidence regarding Verizon's switch discounts might result in a downward adjustment in Verizon's rates, the rates were no less compliant with TELRIC as a result.

  "Third, we see no reason to disagree with the New York Commission that Bell Atlantic's switch costs are not 'interim' merely because they may be adjusted in the future to account for newly adduced evidence. The New York Commission held that, while it had initially been persuaded by Bell Atlantic that it did not receive large switch discounts from its vendors, AT&T later presented new

evidence on such discounts, which the New York Commission will examine in its second network elements rate case. *AT&T has presented no evidence that the New York Commission's 'ongoing examination of the [switch discount] issue betokens a failure to set TELRIC-compliant rates,' nor does it refute the New York Commission's claim that these rates may be refined in the future, 'but they are no less TELRIC-compliant on that account.*'" (¶ 247)

6. AT&T appealed the FCC's decision, yet again raising the argument about the discounts Verizon receives on new switches. The D.C. Circuit upheld the Commission's decision, affirming each of the three grounds on which the Commission relied.

- *First*, the court acknowledged that the New York PSC had established switching rates based on an analysis performed by its own staff.

  "Addressing switching costs in its April 1997 pricing order, the NYPSC began by noting the wide disparity between the estimates provided by Bell Atlantic ($586 per line) and AT&T ($125 per line). Based on that disparity, other evidence in the record, and its own analysis, the agency found 'neither figure ... reliable.' 1997 NYPSC Order at 84. 'In these circumstances,' the NYPSC explained, '[its] staff examined the data on switching costs closely.' Id. at 85. Starting with the historic cost of switches installed in 1993 and 1994, the agency adjusted that cost downward to reflect the declining price of switches, yielding a per-line price of $192.67." (220 F. 3d at 617)

- *Second*, the court upheld the FCC's decision to rely on the PSC's finding that it could not simply modify a single input in isolation, and that doing so likely would require offsetting changes in other inputs.

  "Moreover, both the NYPSC and the FCC agree that adjusting switching rates to reflect discounts is not so simple as subtracting the amount of the discount; it requires other adjustments to the cost model. Under these circumstances, we are comfortable deferring to the Commission's conclusion that basic TELRIC principles have not been violated and that the NYPSC has not made such 'clear errors in factual findings' that switching costs fall 'outside the range that the reasonable application of TELRIC principles would produce.'" (220 F. 3d at 617)

- *Third*, the court upheld the Commission's reliance on the PSC's conclusion that, even if the new evidence regarding Verizon's switch discounts might result in a downward adjustment in Verizon's rates, the rates were no less compliant with TELRIC as a result.

  "The FCC found no problem with the NYPSC's resolution of this issue. 'AT&T has presented no evidence to persuade us that New York did not conform to TELRIC principles simply because it failed to modify one input into its cost model.' Bell Atlantic, 15 F.C.C.R. at 4085 p 245. Sympathetic to the NYPSC's position that 'its determination of allowable switch costs was the result of a complex analysis that does not lend itself to simple arithmetic correction through

the adjustment of a single input,' *the FCC concluded that the prospect of future modification makes the rates no less TELRIC-compliant.* Id. *The FCC's decision seems reasonable to us.* Not only are state-agency-approved rates always subject to refinement, but we suspect that rates may often need adjustment to reflect newly discovered information, like that about Bell Atlantic's future discounts. If new information automatically required rejection of section 271 applications, we cannot imagine how such applications could ever be approved in this context of rapid regulatory and technological change." (220 F. 3d at 617)